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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 873

THE QUAKER OATS COMPANY,
Appellant,

vs.

COMMONWEALTH OF PENNSYLVANIA

APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

APPELLANT'S REPLY TO STATEMENT OPPOSING JURISDICTION AND MOTION TO DISMISS OR AFFIRM.

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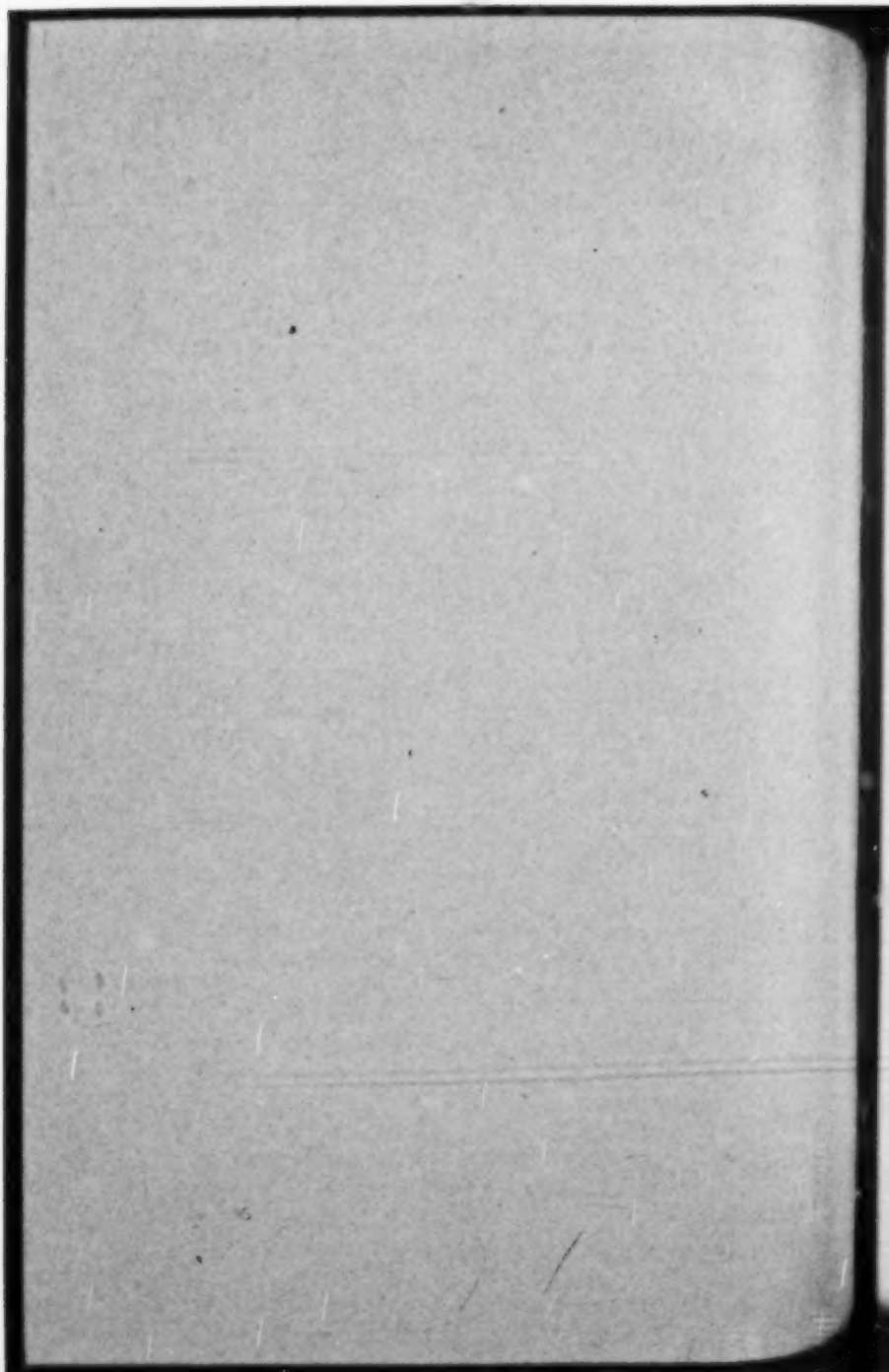

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APPELLANT'S REPLY TO STATEMENT OPPOSING JURISDICTION AND MOTION TO DISMISS OR AFFIRM.

Preliminary Statement

Appellee, on January 5, 1945, filed with the Prothonotary of the Supreme Court of Pennsylvania a typewritten copy of its Statement Opposing Jurisdiction; and served same on appellant on January 8, 1945. Appellee, on January 15, 1945, served on appellant and filed with the Prothonotary of the Supreme Court of Pennsylvania a typewritten copy of its Motion to Dismiss the Appeal in the above case to this Court or to affirm the decision of the Supreme Court of Pennsylvania for the reasons advanced in its Statement Opposing Jurisdiction.

Jurisdictional Question

In determining whether it should take or note jurisdiction in this appeal to review the decision and judgment of the Supreme Court of Pennsylvania against appellant, the only question presented to this Court is whether the issues raised by appellant as set forth in its Statement As To Jurisdiction present substantial federal questions. Appellee contends that they do not because they have been settled by the decisions of this Court. Appellant contends that substantial federal questions are presented which have not been passed upon by this Court or have been decided by this Court, contrary to appellee's contentions and to the rulings thereon by the Supreme Court of Pennsylvania.

There is and could be no dispute by appellee that:

1. Appellant's application for the allowance of an appeal was timely.

2. This appeal is from a final judgment in a suit in the highest court of the State of Pennsylvania in which a decision in the suit could be had.

3. In this suit, there was drawn in question the validity of a statute of the Commonwealth of Pennsylvania and of the tax resettlement made thereunder against appellant on the ground of their being repugnant to the Constitution of the United States.

4. A decision on this question was necessary to the determination of the case.

5. The decision was in favor of their validity.

The Statute and the Tax Resettlement, the Validity of Which Are Involved

The statute of the Commonwealth of Pennsylvania which appellant contends is repugnant to the Constitution of the United States and under which the tax resettlement was

made against appellant for the year 1935, is the Act of May 16, 1935, P. L. 184 (72 Purdon's Statutes, sections 1901, 1902, 1871, 1891, 1892a-1892d) which amended Sections 20 and 21 of the Act of June 1, 1889, P. L. 420. See Appendix to Appellant's Statement as to Jurisdiction for verbatim language of the statute.

Under Section 20 of this statute the *whole* capital stock of appellant was appraised by the Pennsylvania taxing authorities at its actual cash value at December 31, 1935, to wit: $75,000,000. The trial court excluded from the whole valuation, the capital stock value of appellant's investment in the shares of stock of three inactive subsidiary corporations. The tax on appellant was computed under Section 21 (b) of said Act by dividing the remaining capital stock value into thirds and by applying against each third, separate allocation fractions of tangible property, wages and gross receipts. The final tax assessment on appellant, approved by the Supreme Court of Pennsylvania, was calculated as follows:

Tangible Property in Pennsylvania	—	22,440		
			=	.000895
Total tangible property		25,072,615		
Wages paid in Pennsylvania	—	143,259		
			=	.023060
Total wages paid		6,212,221		
Gross receipts in Pennsylvania	—	7,224,347		
			=	.109348
Total Gross Receipts		66,067,332		
				.133303
Average allocation percentage				.044434
Whole Capital Stock Valuation				$75,000,000
Less capital stock value of shares of three inactive subsidiaries having an asset value of $92,609.14				114,196
Capital stock value subject to allocation				$74,885,804
Taxable Valuation ($74,885,804 × .044434)				3,327,476
Tax at five mills				16,637.38

(R. 162a, 252a, 253a).

Counterstatement of the Nature of Appellant's Business

The Quaker Oats Company, appellant, was incorporated under the laws of New Jersey to manufacture and deal in cereals and cereal products, where it had its legal domicile (R. 175a). During the year 1935, it had its principal office and place of business at Chicago, Illinois, which was its business or commercial domicile (R. 183a).

It was duly registered and doing business as a foreign corporation in Pennsylvania prior to the enactment of the Business Corporation Law of May 5, 1933, P. L. 364, 15 Purdon's Statutes, section 2852. As required by said Act, appellant applied for and received from the Commonwealth of Pennsylvania a Certificate of Authority authorizing it to transact as a foreign corporation in Pennsylvania, the business of "selling and dealing in cereals and cereal products" (R. 175a).

During the year 1935, appellant was engaged (1) in the purchase and storage of grains in grain elevators and (2) in the manufacture of cereals and cereal products, both carried on wholly outside of Pennsylvania (R. 177a, 219a), and (3) in selling and dealing in cereals and cereal products, carried on both within and without Pennsylvania (R. 177a, 219a). It also controlled and owned all, or a majority, of the shares of fifteen subsidiary companies, three of which were inactive during 1935, and none of which owned any property or transacted any business in Pennsylvania (R. 177a, 178a, 219a). It maintained a sales organization throughout the United States for the marketing of its products.

In Pennsylvania, appellant had two sales offices, one at Pittsburgh and the other at Philadelphia. At each location, a small inventory of goods was kept in a public warehouse to fill emergency orders. Salesmen connected with

these two offices obtained orders which gave rise to sales in the amount of $7,224,347 as follows:

From Pennsylvania stocks to Pennsylvania customers		$171,773
From stocks outside of Pennsylvannia to Pennsylvania customers	$5,341,783	
From mills outside of Pennsylvania to customers outside of Pennsylvania	1,710,781	7,052,564
Total (out of balance by $10) (R. 145a, 146a, 222a.)		$7,224,337

Except for sales of $171,773 made from Pennsylvania stocks to Pennsylvania customers, the remainder of the sales in the amount of $7,052,574 arising from orders obtained by the Pennsylvania sales offices, were controlled by, and approved or rejected at, appellant's home office in Chicago. There, the customers' credit was passed upon, their accounts were kept, *all invoices were made out except for sales from Pennsylvania stocks;* and shipments were made from stocks or from mills outside of Pennsylvania direct to the customer; and *remittances were made to Chicago* (R. 182a).

Appellant maintained two accounts in each of two banks in Pennsylvania. At each bank was maintained a small branch office expense account. The larger account at each bank *was maintained by collections at Chicago,* and was under the exclusive control of appellant's office there (R. 74a, 98a, 99a).

The total value of appellant's assets was $60,821,913, and the appraised value of its whole capital stock was $75,000,000, so that each dollar of asset value had a capital stock value of $1.23 (R. 179a). Among its total assets were the following:

Land, buildings, machinery and equipment located and employed wholly outside of Pennsylvania in purchasing and storage of grains, and in manufacturing cereals and cereal products (R. 177a, 218a)	$15,703,637.12

United States securities ($14,901,015.67) and State, County and Municipal securities ($1,117,545.39) located and employed wholly outside of Pennsylvania in purchasing and storage of grains (R. 178a, 218a)	16,018,561.06
Stocks of subsidiary corporations (R. 177a, 178a, 219a)	1,663,499.56
Accounts receivable and advances due from subsidiaries (R. 178a)	781,415.76

The amount of tangible property employed by appellant in selling its products in Pennsylvania, consisting of inventory stocks, automobiles and furniture and fixtures, was $22,440, which had a capital stock value of $27,668 (R. 179a, 180a). None of appellant's intangible assets had a business situs or commercial domicile in Pennsylvania (R. 183a).

Substantiality of Federal Questions

Appellant submits that the federal questions raised by it at various stages in this case, as set forth in its Statement As To Jurisdiction, are substantial, and have not been passed upon by this Court or have been decided contrary to the ruling of the court below. Appellee contends that this case presents no substantial federal questions or the questions are so unsubstantial as not to need further argument, and in support of its Motion to Dismiss or Affirm, assigns the reasons advanced in its Statement Opposing Jurisdiction. Appellant opposes the Motion to Dismiss or Affirm, and, in its Reply, will take up each question in the order discussed by appellee in its Statement Opposing Jurisdiction and will show that a substantial federal question is presented and that it has not been passed upon by this Court or has been decided contrary to the ruling of the court below.

(a)

Does the Act of 1935 impose on foreign corporations a tax upon the privilege of doing business in Pennsylvania or a tax upon their property?

It becomes important at the outset to ascertain what is meant by the term "capital stock" which is used in said Act of 1935 as the "measure" of the tax imposed on foreign corporations, and how the amount of such "measure" is determined.

Prior to the year 1935, both domestic corporations incorporated in Pennsylvania, and foreign corporations doing business in Pennsylvania, were subject to a tax upon the actual cash value of their whole capital stock, valued and appraised in the manner set forth in Section 20 of the Act of June 1, 1889, P. L. 420, as amended by the Act of April 25, 1929, P. L. 657. The Supreme Court of Pennsylvania held that the actual cash value of the capital stock of a corporation is a question of fact to be determined from the relevant facts in each particular case, that is, by considering the value of the tangible property of the corporation, and its assets of every kind, including its bonds, mortgages, and moneys at interest, and that it is proper to include in the appraisement of the value of the capital stock the value of the franchises and privileges enjoyed and exercised by the corporation, and to determine the value of these by the material results of their exercise.

Commonwealth v. *Standard Oil Co.*, 101 Pa. 119 (1882);
Commonwealth v. *New York, Pennsylvania & Ohio R. R. Co.*, 188 Pa. 169, 41 Atl. 594 (1898).

The Supreme Court of Pennsylvania and this Court have held that the valuation and appraisal of the capital stock of domestic and foreign corporations at its actual cash value as required under said Section 20 *represents all of*

the property and assets of the domestic or foreign corporation including franchises and privileges, no matter where located.

Commonwealth v. *Standard Oil Co.*, 101 Pa. 119 (1882);
Callery's Appeal, 272 Pa. 255, 116 Atl. 222;
Delaware, Lackawanna & Western R. R. Co. v. *Pennsylvania*, 198 U. S. 341.

In the *Delaware, Lackawanna & Western R. R. Co.*, case, *supra*, this Court said at pp. 356, 357 and 358:

> "• • • We regard this tax as in substance and fact, though not in form, a tax specifically levied upon the property of the corporation, and part of that property is outside and beyond the jurisdiction of the state which thus assumes to tax it. • • •
>
> "So, if the State cannot tax tangible property permanently outside the State and having no situs within the State, it cannot attain the same end by taxing the enhanced value of the capital stock of the corporation which arises from the value of the property beyond the jurisdiction of the State.
>
> "• • • We cannot see the distinction, so far as the question now before the court is concerned, between a tax assessed upon property, eo nomine, or specifically, when outside the State, and a tax assessed against the corporation upon the value of its capital stock to the extent of the value of such property, and which stock represents to that extent that very property. If the property itself could not be specifically taxed because outside the jurisdiction of the State, how does the tax become legal by providing for assessing the tax on the value of the capital stock to the extent it represents that property and from which the stock obtains its increased value? Can the mere name of the tax alter its nature in such case? If so, the way is found for taxing property wholly beyond the jurisdiction of the taxing power by calling it a tax on the value of capital stock or something else, which represents that property. Such a tax, in its nature, by

whatever name it may be called, is a tax upon the specific property which gives the added value to the capital stock."

This Court, therefore, has construed the nature of the tax imposed upon the capital stock of foreign corporations prior to 1935, and held it to be a tax on property. Appellant contends that the nature of the tax remains the same under the Act of 1935.

The said Act of 1935, which amended Sections 20 and 21 of the Act of 1889, continued in Section 21(a) the tax on the capital stock of domestic corporations as theretofore, and in Section 21(b), imposed tax on "the taxable value" of the capital stock of foreign corporations to be determined by the formula provided therein. The basis of the tax on both domestic and foreign corporations *continued to be the appraised actual value in cash of the whole capital stock as provided in Section 20 which remained unchanged.* Therefore, the term "capital stock" when used in the Act of 1935 as the "measure" of the tax on foreign corporations means and represents the same things as theretofore. Section 21(c), which provides that domestic and foreign corporations liable to tax under Section 21 "shall not be required to pay any *further* tax on the mortgages, bonds, and other securities owned by them * * *," is indicative that the tax imposed on foreign corporations under Section 21(b) still remains a tax on property.

Furthermore, no mention is made in Section 21(b) of the Act of 1935 or elsewhere that the tax imposed on foreign corporations is a tax on the privilege of doing business in Pennsylvania. The only reference in said Act to a franchise tax is in the title thereof where it is stated that there is being substituted "a franchise tax on foreign corporations in lieu of the capital stock tax on such corporations." Appellant submits that the tax imposed on the

property of foreign corporations prior to 1935 cannot be converted by the Act of 1935 into a privilege tax merely by *calling* it such, when the same "measure" of the tax with all its characteristics and incidents is retained and the only change is in the method provided for the allocation of the "measure."

The issue as to the nature of the tax imposed on foreign corporations by the Act of 1935 has not been passed upon by this Court. Even though the Supreme Court of Pennsylvania in its opinion in the instant case, 350 Pa. 253, 38 A. (2d) 325, and in the case of *Commonwealth* v. *Columbia Gas & Electric Corporation,* 336 Pa. 209, 8 A. (2d) 404, has held that the said tax is a tax on foreign corporations for the privilege of doing business in Pennsylvania and not a tax on their property, it is well settled that this Court is not bound by the characterization given a state tax by state courts and Legislatures or relieved from the duty of considering the real nature of the tax from its operations and incidents.

Carpenter v. *Shaw,* 280 U. S. 363;
Near v. *State of Minnesota,* 283 U. S. 697;
Educational Films Corp. v. *Ward,* 282 U. S. 379, 387;
The Macallen Co. v. *Mass.,* 279 U. S. 620, 625, 626;
Schuylkill Trust Co. v. *Pennsylvania,* 296 U. S. 113, 119;
Nelson v. *Sears, Roebuck & Co.,* 312 U. S. 359.

And this is particularly so where the opinions of the Supreme Court of Pennsylvania are inconsistent as to the nature of the tax. In *Arrott's Estate,* 322 Pa. 367, 185 Atl. 697, and in *Commonwealth* v. *The Union Trust Company of Pittsburgh,* 345 Pa. 298, 27 A. (2d) 15, it was held that the tax on foreign corporations under the Act of 1935 is in effect "a tax on capital stock" and that "the property included within the folds of the Franchise Tax embraces

the same elements upon which the capital stock tax was based."

The issue as to the nature of the tax presents a substantial federal question. It is a fundamental principle that a tax on property must be imposed according to the value and location of the property. This Court said in *Wheeling Steel Corp.* v. *Fox,* 298 U. S. 193, at p. 208:

> "We have held that it is essential to the validity of such a tax, under the due process clause, that the property shall be within the territorial jurisdiction of the taxing state."

In the instant case, the trial court found that none of appellant's intangible assets had acquired a business situs or commercial domicile in Pennsylvania (R. 183a) and the asset value of appellant's tangible property in Pennsylvania was only $22,440 (R. 179a, 180a, 183a) and yet the taxable value of appellant's franchise as determined is $3,327,476. Clearly, therefore, if the tax imposed on appellant under the Act of 1935 is a tax on its property, the tax is laid on its property outside of Pennsylvania, in violation of the due process provisions of the Fourteenth Amendment.

Appellee in its Statement Opposing Jurisdiction does not contend that this Court has passed upon the issue as to the nature of the tax or that the issue does not present a substantial federal question. It contends that the tax imposed on foreign corporations by the Act of 1935 is a tax on the privilege of doing business and not a tax on property, and advances in support thereof, two propositions:

1. The Supreme Court of Pennsylvania, in its opinions in the instant case and in the case of *Commonwealth* v. *Columbia Gas & Electric Corporation,* 336 Pa. 209, 8 A. (2d) 404, has held that the tax is on the privilege of doing business and not on property.

2. Although conceding that the "measure" of the tax is the value of capital stock representing property value, it is asserted that when the average of the three allocation fractions, (the tangible property fraction, representing property value; and the wages and receipts fractions, representing business activities, and not property value), is applied to the value of the capital stock, the resulting product is not property value but a composite figure representing the value of the privilege of doing business in Pennsylvania. The cases of *Ford Motor Company* v. *Beauchamp*, 308 U. S. 331, and *Society For Savings* v. *Coite*, 73 U. S. (6 Wall.) 590, are cited as authorities for this proposition.

As to the first proposition, we have already pointed out that this Court is not bound by the characterization given a state tax by state courts and Legislatures, and is not relieved from the duty of determining the real nature of the tax from its operations and incidents.

As to the second proposition, there is no authority or foundation for the conclusion reached. Appellant submits that whatever the "measure" of the tax that is used, the result produced by a method of allocation of the "measure" retains the same characteristics as the "measure" because the allocation merely accomplishes a distribution of the "measure" within and without the taxing state. Under the Act of 1889, when capital stock value was the "measure" of the tax on foreign corporations and a mileage fraction was used to allocate the "measure", the result was still capital stock value and a tax thereon was a property tax as this Court held in *Pullman's Palace Car Co.* v. *Pennsylvania*, 141 U. S. 18. In this case, the miles of track of the railroad companies over which the cars of the Pullman Palace Car Company ran did not represent "value" any more than did the wages and gross receipts allocation factors in the instant case. Likewise, this Court held that

the result was property value when in the case of *Massachusetts* v. *Western Union Telegraph Co.*, 141 U. S. 40, the whole value of the capital stock of a telegraph company was allocated by the ratio of the length of telegraph lines in the state to length of lines everywhere.

The ascertainment of the nature of the tax imposed by the Act of 1935 on foreign corporations does not depend, as contended by appellee, upon the transmutation of the "measure" by means of allocation factors into a tax base wholly different in character from that of the "measure." Under the Act of 1935, the "measure" of the tax is the appraised actual cash value of the whole capital stock representing property and asset values; and, appellant submits that the base of the tax represents the same thing no matter what allocation factors are used.

The problem as to the nature of the tax must be resolved by keeping in mind the real nature of the "measure" and the fact that the Act of 1935 is an amendment to Sections 20 and 21 of the Act of 1889 which imposed a property tax on both domestic and foreign corporations; and then determining whether the Act of 1935, which continues the property tax on domestic corporations, does in terms impose a tax on foreign corporations for the privilege of doing business in Pennsylvania, or whether the real nature of the tax from its operations and incidents remains unchanged as a tax on the property of foreign corporations. Appellant submits that this Court should take or note jurisdiction to determine this issue.

The two cases cited by the appellee are not decisive of the issue as to the nature of the tax in the instant case. In the case of *Ford Motor Company* v. *Beauchamp*, 308 U. S. 331, the nature of the tax imposed by the Texas statute was not at issue. There, the taxing statute, which was not an amendment to a property tax statute, by its terms, operations and

incidents imposed a franchise tax, payable in advance, *on both domestic and foreign corporations* for a limited license to do business in Texas for one year. The tax was imposed directly by the Legislature and did not require any valuation. Under the Pennsylvania Act of 1935, the tax is not imposed directly by the Legislature. An appraisal of the "measure" and an assessment of the tax must be made. The measure of the Texas tax, to wit, capital stock, surplus and undivided profits plus long term indebtedness *as shown by the books of the corporation*, does not relate, as does the measure of the tax under the Act of 1935, to the actual value of property and assets; it does not include the value of franchises, privileges and good will, or going concern value; and it does not represent the actual amount or value of capital stock. In the case of *Southern Realty Co.* v. *McCallum*, 65 F. (2d) 934, certiorari denied *290 U. S. 692*, the lower court, speaking of the Texas statute, said at p. 936:

> "But some of the complainants have been unsuccessful and have lost the capital originally represented by their bonds or by their capital stock. Yet the law, *providing for no deduction of a deficit*, measures their tax as though the loss had not occurred." (Italics ours.)

The tax imposed by the Connecticut statute in the second case cited by appellee, to wit, *Society For Savings* v. *Coite*, 73 U. S. (6 Wall.) 590, is not analogous to the tax imposed by the Pennsylvania Act of 1935. There the tax was levied directly by the Legislature in a sum equal to three-fourths of one per cent. on the total amount of deposits of the savings institution as of July 1. Objection was taken to the tax on the ground that it was imposed upon United States securities in which the deposits were invested. This Court sustained the tax as a franchise tax and not a tax on property since it found that no appraisal, either of the investments

or of the value of the deposits, was required. We have shown heretofore that under Section 20 of the Act of 1935, the amount of the measure of the tax, to wit, the actual cash value of the whole capital stock, is determined by an appraisal and valuation of all property and assets including bonds, mortgages, moneys at interest, franchises, privileges and good will. It would appear, therefore, that the *Coite* case is authority for appellant's contention that the tax imposed by the Act of 1935 is a tax on property *since an appraisal and valuation of property and assets is required.*

This Court's attention is called to the fact that Pennsylvania did impose for the year 1935 another and a different tax *on domestic and foreign corporations for the privilege of doing business in Pennsylvania* measured by net income arising from business activities. See the Act of May 16, 1935, P. L. 208, 72 Purdon's Statutes, sections 3420a-3420n, and the case of *Turco Paint and Varnish Co.* v. *Kalodner*, 320 Pa. 421, 184 Atl. 37. In the instant case, the "measure" of the tax is made up of property and asset value.

(b)

Is the method of allocation provided in the Act of 1935 inherently arbitrary and unreasonable?

This issue presents a substantial federal question under the due process clause and has not been passed upon by this Court, nor do its decisions have direct application.

Regardless of whether the tax imposed by the Act of 1935 on foreign corporations be a tax on the privilege of doing business or a tax on their property, appellant contends that the method of allocation provided in said Act for the allocation of the "measure" of the tax—consisting, as it does, wholly of property and asset values—is

inherently arbitrary and unreasonable for the following reasons:

1. The allocation factors of tangible property, wages and gross receipts, which are used in the method of allocation, have been held "to reflect the relative contribution of the activities in the various states to the production of the unitary *income*" of a corporation:

Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113;

Bass, Ratcliff & Gretton, Ltd., v. *Commission*, 266 U. S. 271;

North American Cement Co. v. *Graves*, 299 U. S. 517;

Butler Bros. v. *McColgan*, 315 U. S. 501;

Turco Paint and Varnish Co. v. *Kalodner*, 320 Pa. 421, 184 Atl. 37.

and are not appropriate for the allocation of capital stock value made up of *property and asset values*. When such a "measure" of the tax is selected, the allocation factors must vary within and without the state, in substantially the same proportion as the selected "measure" varies. That the allocation factors used in the Act of 1935 do not meet this test is conceded by appellee when it says on page 7 of its Statement Opposing Jurisdiction:

> "While the three fractions are applied to the value of the capital stock, two of the three fractions do not depend at all upon property or the amount thereof."

See also *Maxwell* v. *Kent-Coffey Manufacturing Co.*, 204 N. C. 365, 168 S. E. 397, 400, 402, affirmed 291 U. S. 642.

2. The method of allocation is defective in that no representation is given therein to appellant's intangible assets which comprise 58% of its total assets and all of which are located and used outside of Pennsylvania (R. 183a).

The case of *People ex rel. Alpha Portland Cement Co.* v. *Knapp,* 230 N. Y. 48, 129 N. E. 202, certiorari denied, 256 U. S. 702, supports this proposition. There was involved in that case a New York statute which provided for the apportionment of the business income of a corporation, including dividends and interest, by a formula which failed to include the value of interest bearing bonds and 90% of the value of dividend paying stocks. Concerning the formula, the late Mr. Justice Cardozo, then on the bench of the Court of Appeals of New York, speaking for the court, said at p. 206 (129 N. E.):

> "It measures the value of the franchise, here and elsewhere, by income from all sources, and excludes some of the same sources when the value is apportioned. To take from the assets elsewhere is equivalent to adding to assets here. * * * The principle of allocation is not followed to its natural and obvious outcome in accordance with the situs of the assets, but is consciously checked, its normal course is thwarted by an artificial and designed exception. Something which, in the absence of express exclusion, would be within its operation, is knowingly taken out of it. I am unable to avoid the conclusion that a method of apportionment which purposely ignores realities, which compels an assessor to look to some of the assets only, and close his eyes to all of the others, is arbitrary and unreasonable in its increase of the local burden."

3. The method of allocation, when applied to the actual value of appellant's whole capital stock, does not determine the true value of its capital and property employed in Pennsylvania but arbitrarily allocates to Pennsylvania, as the base of the tax, the capital stock value of all of its assets, both tangible and intangible, regardless of their

location, situs or use, to the extent of the average percentage of the allocation fractions in Pennsylvania.

Wallace v. *Hines,* 253 U. S. 66;
Fargo v. *Hart,* 193 U. S. 490.

Appellee, on the other hand, contends that the method of allocation provided in the Act of 1935 is not arbitrary or unreasonable, and advances in support thereof three propositions:

1. That the case of *Butler Bros.* v. *McColgan,* 315 U. S. 501, is controlling in the instant case because in that case allocation factors of tangible property, payroll and receipts, which were similar to those provided in the Pennsylvania Act of 1935, were approved as appropriate "ingredients of an apportionment formula."

2. That the ruling in the *Butler* case, *supra,* is directly contrary to the ruling in the case of *People ex rel. Alpha Portland Cement Co.* v. *Knapp, supra,* cited by appellant.

3. That no distinction can be made between the use of the allocation factors as provided in the Act of 1935 in the allocation of net income and their use in the allocation of capital stock, because the use of similar allocation factors in the allocation of capital stock has been approved in *Ford Motor Company* v. *Beauchamp,* 308 U. S. 331, and in *Ford Motor Company* v. *Oklahoma Tax Commission,* 188 Okla. 78, 106 Pac. (2d) 803.

As to the first proposition, appellant submits that the *Butler* case, *supra,* is not controlling in the instant case on the issue as to the arbitrariness of the method of allocation. In that case, *net income* was the "measure" of the tax. With reference to the use of the allocation fac-

tors of tangible property, payroll, and receipts, Mr. Justice Douglas speaking for this Court said at p. 509:

> "We agree with the Supreme Court of California that these factors may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of the total unitary income' so as to allocate to California its just proportion of the profits earned by appellant from this unitary business."

Appellant concedes that these allocation factors are appropriate for the allocation of the *principal business income* of a manufacturing corporation for the reasons stated by Mr. Justice Douglas. It has not questioned the settlement of tax on its *net income* for 1935, which was imposed by the Pennsylvania Act of May 16, 1935, P. L. 208, 72 Purdon's Statutes, sections 3420a-3420n, in which these factors were used for the allocation of *net income.*

In the instant case, the "measure" of the tax is the actual cash value of appellant's whole capital stock. As shown heretofore, the only factors contributing to capital stock value, as used in the Act of 1935, are property and asset values. On the authority of the *Butler* case, allocation factors which are representative of and contribute to capital stock value should be used in the Act of 1935. On page 12 of its Statement Opposing Jurisdiction, *appellee concedes that this has not been done* when it says:

> "The state makes no presumption * * *, 'that capital or property is employed in the same ratio as business activities.' The purpose of the Pennsylvania statute in employing the wages fraction and the gross receipts fraction in the formula, is to measure business activity to an extent that property might not do it, in order to obtain a fairer valuation of the privilege or franchise to be taxed."

Since appellee concedes that the allocation factors as provided in the Act of 1935 are representative of business activities, and that capital or property, which constitute the "measure" in the instant case, is *not* employed in the same ratio as business activities, it follows that too little or too much of the "measure" is allocated to Pennsylvania as the basis of the tax; and for this reason appellant submits that the method of allocation is inherently arbitrary and unreasonable.

As to the second proposition, appellant submits that the ruling in the *Knapp* case, supra, is not contrary to the ruling in the *Butler* case, supra; and that therefore the *Knapp* case is authority for appellant's proposition that the method of allocation as provided in the Act of 1935 is inherently arbitrary and unreasonable because no representation is given therein to appellant's intangibles which comprise 58% of its total assets and capital stock value.

The *Butler* case involved the Bank and Corporation Franchise Tax Act of California. 2 Gen. L., Act 8488, p. 3851; Stat. 1929, p. 19; amended, Stat. 1931, p. 2226; Stat. 1935, p. 965. The 1931 amendment provided that income from intangible personal property, except dividends, upon which the tax had been paid by the declaring corporation, shall be subject to allocation. This amendment was repealed by Ch. 275 of the Laws of 1935.

On December 4, 1936, a Regulation was adopted by the State Board of Equalization (See The Corporation Tax Service, California, Vol. 1, paragraph 5-804) which provided that:

> "In the case of corporations organized under the laws of the state and foreign corporations *which have acquired a commercial domicile within the state,* the measure of the tax * * *", (Underscoring Ours)

shall include income from intangible personal property, except dividends upon which tax has been paid by the declaring corporation; and that,

> "In the case of other corporations, income from intangible personal property is included in the measure of the tax only if the intangibles have acquired a business or taxable situs in this state"

The opinion of the Attorney General of California, No. 7467a, dated April 2, 1931, is substantially to the same effect.

In the *Butler* case, an Illinois corporation was involved and the "measure" of the tax was net income. There was no evidence in the record that it had acquired a commerical domicile in California, or that any of its intangibles had acquired a business situs there; but even if these conditions had existed, the *whole* of the income from intangibles would have been assigned, under the Regulation referred to above, to California without the use of any allocation factors. In that case, therefore, the allocation factors, similar to those in the Pennsylvania Act of 1935, were applied to allocate only the principal business income, that is, the income from buying and selling merchandise, *not including* income from intangibles. Accordingly, the ruling of this Court upholding the use of the allocation factors in the *Butler* case is not contrary to the ruling in the *Knapp* case which held that the method of allocation there involved was arbitrary and unreasonable unless representation be given therein to the intangible asset values producing the net income to be allocated or unless the income from intangibles be excluded from the net income to be allocated. Accordingly, in the latter case, bond interest was eliminated from net income, and stock values were added to the asset values without the state in the allocation formula.

Appellant submits that both of these cases support its proposition that the method of allocation as provided in the Act of 1935 is inherently arbitrary and unreasonable because no representation is given therein to appellant's intangible assets which comprise 58% of its total assets and capital stock value.

As to the third proposition, the fact that the use of allocation factors similar to those provided in the Act of 1935 have been approved in the allocation of capital stock in cases arising under the franchise tax statutes of other states, is not controlling in the instant case, as contended by the appellee. The two cases cited by the appellee are *Ford Motor Company* v. *Beauchamp,* 308 U. S. 331, and *Ford Motor Company* v. *Oklahoma,* 188 Okla. 78; 106 P. 2d 803. The latter relied wholly upon the former. Differences in the Pennsylvania and Texas statutes in the nature of the tax, the "measure" of the tax, the time of the imposition of the tax, and the purpose for which the tax is imposed, refute appellee's contention. These differences are detailed at pages 19 and 20 of appellant's Statement As to Jurisdiction.

Furthemore, in the Oklahoma case, the asset allocation ratio includes all assets, both tangible and intangible, and, in both cases, the gross receipts allocation ratio in the taxing state is limited to wholly intrastate business only, whereas, in the instant case, a tangible property allocation ratio is used and the gross receipts fraction includes interstate receipts.

(c)

Even if the tax imposed by the Act of 1935 be a franchise tax, does the method of allocation used result in imposing tax upon, or measuring the tax by, property of appellant located and employed outside of Pennsylvania?

This issue presents a substantial federal question under the due process clause and has not been passed upon by this Court.

The trial court in the instant case found that none of appellant's intangible assets had acquired a business situs in Pennsylvania (R. 183a); that appellant had not acquired a commercial domicile in Pennsylvania (R. 183a); that each asset dollar had a capital stock value of $1.23 (R. 179a) or an enhanced value of 23¢; and that the appellant had tangible property employed in Pennsylvania in the amount of $22,440 (R. 179a, 180a) which had a capital stock value of $27,668 ($22,440 x $1.23). These findings of the trial court were not overruled by the Supreme Court of Pennsylvania in its opinion in the instant case.

Appellant contends that, when, in the face of these findings by the trial court, the taxable value of appellant's franchise is determined to be $3,327,476, the result is the imposition of tax upon appellant's property located and employed outside of Pennsylvania. This is caused by the application of the three allocation factors to appellant's whole capital stock value (with a minor exception) regardless of the location, situs or use of its assets. This showing is proof by appellant of the taxation of extraterritorial values even though the use of similar allocation factors has been approved in cases arising under the franchise tax statutes of other states.

Appellee contends that neither the Act of 1935 nor the method of allocation used in this case imposes a tax upon

property located outside of Pennsylvania, and advances in support thereof three propositions:

1. That the Supreme Court of Pennsylvania has held that the Act of 1935 does not impose a tax upon property whose situs is beyond the limits of the State, citing *Commonwealth* v. *Columbia Gas & Electric Corporation,* 336 Pa. 209, 8 A. (2d) 404.

2. That this Court has frequently held that while a state may not tax property beyond its borders, it may measure a tax by capital stock which, in part, represents property outside the state, citing:

Kansas City, Memphis & Birmingham Railroad Co. v. *Stiles,* 242 U. S. 111;

Atlantic Refining Company v. *Virginia,* 302 U. S. 22;

Ford Motor Co. v. *Beauchamp,* 308 U. S. 331;

Great Atlantic & Pacific Tea Co. v. *Grosjean,* 301 U. S. 412;

Underwood Typewriter Co. v. *Chamberlain,* 254 U. S. 113;

Bass, Ratcliff & Gretton, Ltd., v. *State Tax,* 266 U. S. 271.

3. That the business or commercial situs of intangible assets is irrelevant in applying the formula to determine the value of the franchise of a foreign corporation to do business in the taxing state, the only test as to their use being whether they contribute to the activity carried on in the taxing state, citing:

National Leather Company v. *Massachusetts,* 277 U. S. 413.

In support of its first proposition, appellee refers to the opinion of the Supreme Court of Pennsylvania in the *Columbia* case where that court, in speaking of the method

of allocation provided in the Act of 1935, said at pp. 221 and 222:

> "It does not ascertain physical worth of assets located in this state, but arrives at a value which the functional or operating unit within this state possesses. It represents what the right to do business is worth. It must follow that the tax is not levied on property but on the franchise to do business measured by a taxable value secured through the application of the factors of gross receipts, tangibles and payrolls to the capital stock value. It is representative of the value of that very franchise."

In the instant case, the Supreme Court of Pennsylvania relied upon its former opinion in the *Columbia* case in holding that appellant's property outside of the state was not taxed. In the *Columbia* case, however, the Supreme Court of Pennsylvania, when it came to apply the general principles which it had been discussing to the record of facts in that particular case, found that the tax appealed from was imposed on the corporation's property outside of the state and accordingly, revised the tax so as to be based only upon the capital stock value of tangible and intangible assets employed by the corporation in the exercise of its franchise in the state. The court said, at pp. 225 and 226 of its opinion:

> "By these principles it is obvious that since the tax is nothing but one upon the value of a privilege and taxable measure is fundamentally *the capital stock used in connection with that privilege*, we must for the purpose of determining the validity of the tax separate from it that capital stock value which bears no relation to the privilege." (Italics ours.)

Likewise, appellant submits that the record of facts in the intant case, as indicated above, shows that the tax imposed on it is not based upon the capital stock value of its

tangible and intangible assets employed in the state but is based upon, or measured by, property and assets outside of the state.

If the Supreme Court of Pennsylvania, in the excerpt from its opinion in the *Columbia* case relied upon appellee, and appellee, at pp. 7 and 8 of its Statement Opposing Jurisdiction, are saying that the application of the allocation factors as provided in the Act of 1935 to the capital stock value of a foreign corporation transmutes the capital stock value into a result which is wholly unrelated to property and asset values, such statements and conclusion are contrary to this Court's finding in *Delaware, Lackawanna and Western R. R. Co.* v. *Pennsylvania,* 198 U. S. 341. There, this Court held that capital stock value, as used in the Act of 1889, to which the Act of 1935 is an amendment, represents property and asset values, and that a tax thereon is a tax on the property and assets making up such value.

Appellant submits that in view of the nature of the "measure" of the tax selected in the Act of 1935, the purpose of the method of allocation must be the determination of the true value of capital and property employed by appellant in Pennsylvania. This purpose is not accomplished in the instant case, as shown by appellant above, and for the reasons given in its discussion heretofore of the nature of the tax and the arbitrariness of the method of allocation. As will be developed hereinafter, if the method of allocation is to be retained, appellant's capital stock value must be limited to the capital stock value of its assets employed in its selling business and the allocation factors must be limited likewise since it is only that business which is carried on both within and without Pennsylvania.

As to the second proposition, distinction must be made between the whole "measure" of the tax and the part of the

"measure" to which the tax rate is applied, which is obtained by allocation. Appellant concedes that the whole capital stock value representing property and assets everywhere may be used as the "measure" but submits that this Court has held that the part of the "measure," which is the base of the tax, may not include, in the case of foreign corporations, extraterritorial values or activities.

James v. *Dravo Contracting Co.*, 302 U. S. 134;
Connecticut General Life Ins. Co. v. *Johnson*, 303 U. S. 77;
Wallace v. *Hines*, 253 U. S. 66;
Fargo v. *Hart*, 193 U. S. 490;
Delaware, Lackawanna & Western R. R. Co. v. *Pennsylvania*, 198 U. S. 341.

The cases cited by appellee in support of its proposition are not applicable in the instant case and may be distinguished on several grounds: the nature of the tax involved, the nature of the "measure," whether the tax is imposed before or after the privilege has been exercised, and whether the tax is imposed on a domestic or foreign corporation.

In the *Stiles* case, *supra*, and in *Kansas City, Ft. Scott & Memphis Railway Co.* v. *Botkin*, 240 U. S. 227, upon which the former relied, this Court held that the domiciliary state had the power to impose upon *domestic* corporations a franchise tax upon the entire authorized capital stock represented in part by property beyond the taxing state. However, this Court held in other cases that a franchise tax on *foreign* corporations could be imposed only on that part of the *issued capital stock within the taxing state.*

Roberts & Scheaffer Co. v. *Emmerson*, 271 U. S. 50;
Airway Corp. v. *Day*, 266 U. S. 71;
Cudahy Packing Co. v. *Hinkle*, 278 U. S. 460.

The Atlantic Refining Co. case, *supra,* involving an entrance fee imposed on a foreign corporation at the time of admission to do business in the taxing state; the *Great Atlantic & Pacific Tea Company* case, *supra,* involving a graduated tax on chain stores; and the *Ford Motor Company* case, *supra,* involving a franchise tax payable in advance by a foreign corporation for a limited license to do business in the taxing state for one year, advance the theory that the privilege acquired from the taxing state is dependent in value upon the possession of large financial resources outside of the taxing state which are available for use in the exercise of the privilege granted by the taxing state. Upon the payment of the tax, the taxpayer, in these cases, may bring additional capital into the taxing state or increase its volume of business there without increasing the amount of its tax during the tax period.

This theory is not applicable in the instant case, Appellant, in 1933, received a Certificate of Authority to do business in Pennsylvania for an unlimited period of time. If the Act of 1935 imposes a tax on appellant for the privilege of doing business in Pennsylvania, the tax is imposed *after* the privilege has been exercised and is based upon the amount of capital that had been employed in the exercise thereof in Pennsylvania. Failure to pay the tax does not result in forfeiture of the right to do business in Pennsylvania.

At pp. 22 and 23 of Appellant's Statement As To Jurisdiction, further distinguishing features of the Texas tax involved in the *Ford Motor Company* case, *supra,* are pointed out.

The *Ford Motor Company* case, and the *Underwood Typewriter Co.* and *Bass, Ratcliff & Gretton* cases, the latter two involving net income as the measure of the tax, develop the unitary enterprise theory. This theory ap-

pears to have originated in the *Bass* case. There, this Court held that a company engaged in purchasing of raw materials and manufacturing in a foreign country and selling its products in New York constituted a unitary enterprise, and that, since its net income was produced by the series of transactions, the entire income was subject to allocation. The allocation factors used were deemed to "reflect the relative contribution of the activities in the various states to the production of the unitary income." In so far as the record shows, the allocation factors were applied only to the so-called unitary income arising from manufacturing and selling ale—and not to income from intangibles.

In the instant case, appellant's capital stock value which is the "measure" of the tax is not produced by a series of business transactions but by property and asset values, as had been shown heretofore. Therefore, a proper application of the unitary theory would require that the allocation factors be representative of property and asset values, including intangibles. That this is not done is conceded by appellee.

Even though engaged in a unitary enterprise, appellant employs different capital in varying amounts in different activities. It is not engaged in a single activity with the same capital employed throughout its enterprise. Therefore, when allocation factors not representative of capital and property are applied to capital stock value, the true value of the property employed in Pennsylvania correlated in use with total property is not determined, but there is allocated to Pennsylvania a proportion of the capital stock value of all property and assets no matter where located and employed. Appellant submits that, if the method of allocation provided in the Act of 1935 is to be retained, it must be limited and applied only to

appellant's capital stock value pertaining to its selling business, in which common capital would most likely be employed in and out of Pennsylvania.

As to the third proposition, if business or commercial situs of intangible assets is to be disregarded, the question in determining whether they are to be included in the tax computation, is not whether they *contribute* to the activity in the taxing state, but whether they are *used* in the activity in the taxing state. This is aptly illustrated by the case of *National Leather Co.* v. *Massachusetts,* 277 U. S. 413.

There, the question was whether the investment in the stocks of two subsidiary companies by a foreign corporation doing business in Massachusetts represented capital employed by it in the state so as to be included in the numerator of the asset fraction which was to be applied to the capital stock value of its corporate excess in the computation of its tax. This Court held that even though the stocks might not have a business or commercial situs in Massachusetts they represented capital employed by the foreign corporation in carrying on its business in the state *"to the extent, at least, that the controlled activities and property of the subsidiary corporations were within the state."*

On the authority of this case, appellant's investment in United States securities, State, County and Municipal securities and in shares of stock of subsidiary corporations should be excluded from the computation of its tax because they were located, employed and used outside of Pennsylvania in functions and activities wholly different from its selling activity in Pennslyvania (R. 178a, 184a, 185a, 188a).

Contrary to appellee's contention, the business or commercial situs of intangibles is important in the cases arising under the franchise tax statutes of other states. See:

New York v. *Latrobe*, 279 U. S. 421 (New York);
International Shoe Co. v. *Shartel*, 279 U. S. 429 (Mo.);
Hump Hairpin Manufacturing Co. v. *Emmerson*, 258 U. S. 290 (Illinois);
Ford Motor Company v. *Okla. Tax Commission*, 106 P. 2d 803 (Oklahoma).

In these cases, the rule of business situs or commercial domicile was applied to determine whether intangible assets were to be included in the numerator of the asset allocation fraction in the tax computation.

Appellant concedes that it is a unitary enterprise in the sense that it is an integrated concern engaged in purchasing of raw materials and the manufacturing and selling of cereals and cereal products. All of its property and assets contribute to and produce the actual cash value of its whole capital stock which includes total enhancement in value by reason of correlation in use of its property within and without Pennsylvania. In the instant case, each asset dollar has a capital stock value of $1.23 (R. 179a), or an enhanced value of 23 cents.

The Supreme Court of Pennsylvania and appellee say that the true correlated value of appellant's property employed in Pennsylvania is to be determined by the proportion of the allocation factors applied to appellant's whole capital stock value which, appellant contends, results in allocating to Pennsylvania not only a proportion of the asset value of property located and employed outside the state but also a proportion of the enhanced value of such assets as reflected in the whole capital stock valuation. This is shown by the fact that the taxable valuation obtained is $3,327,476 which is 143 times the asset value

of $22,440 employed in Pennsylvania. This result is produced because the allocation factors are not representative of location and use of assets.

Appellant submits that the application of the theories of unitary enterprise and correlation of use of assets can be made effectively and properly in the instant case, only by the use of an asset ratio of property employed in that state total assets applied to its whole capital stock value because the basis of the tax is the capital stock value of property employed in Pennsylvania. It has already paid a privilege tax for 1935 on the basis of business activities producing income, under the provision of the Act of May 16, 1935, P. L. 208, 72 Purdon's Statutes, sections 3420a-3420n.

(d)

The case of Ford Motor Company v. Beauchamp, 308 U. S. 331.

Appellee contends that the principles of this case are applicable in the instant case. Appellant has pointed out the distinguishing features of the Texas and Pennsylvania statutes at pages 22 and 23 of its Statement As To Jurisdiction and submits that the *Ford* case is not applicable in the instant case because of the differences there pointed out and the difference in the power to impose the particular kind of tax selected.

The difference in the power of a State over entrance fees and over taxes was pointed out by this Court in *Hanover Fire Insurance Co.* v. *Harding,* 272 U. S. 494, at pages 510 and 511.

The amount and basis of the entrance fee which a State may impose upon a foreign corporation seeking admission to do business are almost wholly within the discretion of

the State, *Atlantic Refining Co.* v. *Virginia*, 302 U. S. 22. Under the Texas statute, a franchise tax is imposed for a limited license to do business for one year, *Southern Realty Co.* v. *McCallum*, 65 F. (2d) 934, certiorari denied 290 U. S. 692, and is in the nature of an entrance fee. Since the tax is imposed after the corporation has been admitted but *before* it begins business for the tax year, the "measure" of the tax is apportioned to avoid violation of the Commerce Clause. Upon payment of the tax, the corporation may increase the volume of its business or the amount of capital employed without increasing its tax during the year.

Tax under the Pennsylvania Act of 1935 is imposed on appellant after it had been admitted to do business in the state. It is not imposed for the privilege or license to do business, but after the exercise of the privilege. The power to impose such a tax is more limited. Furthermore, the Act of 1935 itself contains limitations by reason of the nature of the "measure" of the tax selected, which contemplates as the basis of the tax the capital stock value of property and assets employed by appellant in Pennsylvania. Therefore, appellant submits that the principles applicable to the Texas tax and basis of apportionment are not applicable in the instant case where the tax is wholly different.

(e)

Do the Act of 1935 and the tax imposed on appellant thereunder deny to it the equal protection of the laws?

Appellant contends that this issue presents a substantial federal question which has been decided by this Court contrary to the rulings of the Supreme Court of Pennsylvania in the instant case.

Appellant owned United States securities valued at $14,901,015 (R. 178a) and shares of subsidiary corporations valued at $1,663,499 (R. 177a, 178a). Prior to 1935, such investments when owned by either domestic or foreign corporations, were not taxed. Under the Act of 1935, which retained the same "measure" of tax on both domestic and foreign corporations, to wit, the actual value in cash of the whole capital stock, such investments were included in the computation of the tax on appellant and increased its tax by $4,537.61 but were exempted from tax when owned by domestic corporations of the same kind (R. 183a, 184a, 185a). Thus the tax base for domestic corporations is less than the whole because of exemptions allowed, but the tax base for appellant and other foreign corporations is *the full amount* of the capital stock value attributed to Pennsylvania. Under these circumstances, appellant contends that, on the basis of the decisions of this Court in *Southern Railway Co.* v. *Greene*, 216 U. S. 400, and in *Hanover Fire Insurance Co.* v. *Harding*, 272 U. S. 494, it is discriminated against and denied the equal protection of the laws. These cases involved taxes imposed on foreign corporations after having been admitted to do business. The same situation exists in the instant case.

Appellee contends that the question presented is not substantial and advances in support thereof, four propositions:

1. That the purpose of the Act of 1935 was not to discriminate against foreign corporations but to remove the discrimination against domestic corporations which previously existed.

2. That a state may place a foreign corporation in a different class from domestic corporations for the purpose of taxation and impose a different rate of tax upon the

foreign corporation for the privilege of doing business within its territory, citing:

Kansas City, Memphis & Birmingham Railroad Co. v. *Stiles,* 242 U. S. 111;
Madden v. *Kentucky,* 309 U. S. 84;
Concordia Fire Insurance Co. v. *Illinois,* 29 U. S. 535;
Kidd v. *Alabama,* 188 U. S. 730;
Cheney Brothers Company v. *Massachusetts,* 246 U. S. 147.

3. That the *Southern Railway Co.* and *Hanover Fire Insurance Co.* cases can be distinguished.

4. That appellant has not proved that it has been discriminated against since, if it were a domestic corporation, its tax would be ten times more than the tax imposed against it under the Act of 1935.

As to the first proposition, appellant submits that no matter what the purpose of the Act of 1935 was, the result of its provisions and operation is to discriminate against appellant and other foreign corporations similarly situated when the basis of the tax on foreign corporations is *the full amount* of capital stock value attributed to Pennsylvania and the basis of the tax on domestic corporations is less than the full amount of capital stock value attributed to Pennsylvania because of exemptions allowed. The purpose of the Act of 1935 to reach the intangibles of foreign corporations that were taxed to domestic corporations is not accomplished without discrimination when all of the intangibles of foreign corporations but not all of the intangibles of domestic corporations in Pennsylvania are taxed. The denial to foreign corporations of the exemptions allowed to domestic corporations of the same kind is the very essence of discrimination.

As to the second proposition, appellant concedes that, at the time of seeking to do business in a state, foreign corporations may be separately classified and taxed, but appellant submits that the cases cited by appellee do not support the proposition that foreign corporations, after having been admitted, may be separately classified, unless substantial differences exist, and a greater tax burden be imposed on them than on domestic corporations of the same kind.

In the *Stiles* case, and in the *Cheney Brothers Company* case, the basis of the tax on domestic corporations is the *whole* of the "measure" without any exemptions, while the basis of the tax on foreign corporations is only that part of the "measure" within the taxing state.

In the *Concordia Fire Insurance Co.* case, it was not shown that the tax on domestic and foreign corporations was not equivalent. In Pennsylvania, the tax burden on foreign corporations is greater than on domestic corporations. Both domestic and foreign corporations are subject to tax on their net income under the Act of May 16, 1935, P. L. 208, 72 Purdon's Statutes, sections 3420a-3420n; and are subject to tax under the Act of 1935 involved in the instant case, but under said Act, exemptions are allowed to domestic corporations and not to foreign corporations. This difference of treatment under the said Act of 1935 increases appellant's tax by $4,537.61.

In the *Kidd* case, shares of foreign corporations not doing business in Alabama were taxed in the hands of resident shareholders while shares of domestic corporations and foreign corporations doing business in the state were not taxed.

The *Madden* case involved the taxation by Kentucky of the bank deposits of a resident in the state at a lower rate than his bank deposits in another state.

The only basis for separate classification and taxation of foreign corporations in the Act of 1935, as found by the trial court (R. 192a), is difference in domicile only. This Court held in *Hanover Fire Insurance Co.* v. *Harding*, 272 U. S. 494, at page 511, that "after its admission, the foreign corporation stands equal, and is to be classified with domestic corporations of the same kind."

As to the third proposition, appellant submits that the *Southern Railway Co.* and *Hanover Fire Insurance Co.* cases cannot be distinguished and are applicable in the instant case. Appellee attempts to distinguish these cases on the ground that in the first case the railroad company's investments in the state were permanent and in the second case, "the insurance company had done business in Illinois for a number of years and had built up a large business and good will and had many agents and extensive records there." This Court, in the *Hanover Fire Insurance Co.* case, at p. 508, held that the distinction as to permanency of investments is not controlling. Except for probable difference in extent of doing business in the taxing state, appellant's situation in Pennsylvania is similar to that of the insurance company involved in the *Hanover Fire Insurance Co.* case.

As to the fourth proposition, appellant submits that the comparison of the tax appellant would pay if it were a domestic corporation with the tax imposed against it as a foreign corporation cannot be made the test to determine whether appellant is being discriminated against. This tax comparison is wholly without foundation in the law and presupposes a situation that doesn't exist. Pennsylvania has no power to tax appellant, as a foreign corporation, to the same extent as if it were a domestic corporation unless appellant did everything or had acquired a commercial domicile in Pennsylvania, which is not the fact in the instant case.

The domiciliary state may impose a franchise tax on domestic corporations measured by *their entire authorized capital stock*, but such a tax on foreign corporations violates the due process and commerce clauses of the Federal Constitution.

Kansas City, Ft. S. & M. Co. v. *Kansas*, 240 U. S. 227;
Roberts & Scheafer Co. v. *Emmerson*, 271 U. S. 50.

The domiciliary state may impose tax upon *all* of the intangibles of a domestic corporation on the basis of presumption of situs at the domicile;

Cream of Wheat Co. v. *Grand Forks*, 253 U. S. 325;
Newark Fire Ins. Co. v. *State Board*, 307 U. S. 313;

but may impose tax only upon such intangibles of a foreign corporation as have acquired a business or commercial situs in the taxing state.

Wheeling Steel Corp. v. *Fox*, 298 U. S. 193.

The test proposed by appellee, and adopted by the Supreme Court of Pennsylvania, for use in determining whether appellant is discriminated against is the same as saying that an otherwise unconstitutional tax on appellant is constitutional because that is the amount of tax appellant would be made to pay if it could be induced to become a domestic corporation, and thus create a domiciliary situs for its intangibles in Pennsylvania. Such an attempt by way of supposition to support an unconstitutional tax was condemned by this Court in *Connecticut General Life Insurance Co.* v. *Johnson*, 303 U. S. 77, where it said, at p. 81:

> "It follows that such a tax, otherwise unconstitutional, is not converted into a valid exaction merely • • • *because the state might tax transactions which the corporation carried on outside the state if it were induced to carry them on within.*" (Italics ours.)

Appellant submits that the proper test to use in determining whether it is being discriminated against is a comparison of the tax burden on it and a domestic corporation of the same kind *on the same amount of comparable capital or property;* and this test shows that appellant's tax is increased $4,537.61 by reason of its ownership of United States securities and shares of subsidiary corporations which are exempted to domestic corporations.

(f)

Do the Act of 1935 and the tax imposed on appellant thereunder impair the obligation of the contract between appellant and the Commonwealth?

This issue presents a substantial federal question and is submitted by appellant to have been ruled in its favor by the decision of this Court in *American Smelting and Refining Co.* v. *Colorado,* 204 U. S. 103.

Appellant contends that a contract guaranteeing to it equality of taxation with domestic corporations of the same kind was created between it and the Commonwealth of Pennsylvania by the Act of May 28, 1907, which was later repealed and its provisions written into Section 1010 of the Business Corporation Law of May 5, 1933, P. L. 364, 15 Purdon's Statutes, section 2852, which provides:

> "A foreign business corporation which shall have received a certificate of authority under this Act, so long as such certificate of authority shall not be revoked or cancelled, shall enjoy the same rights and privileges as a domestic business corporation, but no more, and, except as in this act otherwise provided, *shall be subject to the same liabilities, restrictions, duties and penalties now in force or hereafter imposed upon domestic business corporations,* to the same extent as if it had been organized under this Act to transact the business set forth in its certificate of authority." (Italics ours.)

Appellant submits, on the authority of the *American Smelting and Refining Co.* case, that the Act of 1935 impaired the obligation of this contract when the said Act as applied to appellant increased its tax by $4,537.61 by reason of its ownership of United States securities and shares of subsidiary corporations, which when owned by domestic corporations of the same kind are exempted from capital stock tax. In that case, this Court held that the provisions of the Colorado law which were similar to the provisions of Section 1010 of the Pennsylvania Business Corporation Law of 1933 created a contract with foreign corporations, *after they had previously been admitted to do business,* which guaranteed to them equality of taxation with domestic corporations; and that this contract was impaired by an Act imposing a state license tax on domestic corporations at the rate of *two cents* upon each $1,000 of their capital stock and on foreign corporations at the rate of *four cents* upon each $1,000 of their capital stock. In the instant case, although the tax rate on both domestic and foreign corporations is five mills, the allowance of exemptions to domestic corporations that are not allowed to foreign corporations produces, in effect, a lower tax rate for domestic corporations.

The Supreme Court of Pennsylvania, without finding that a contract existed and what its terms were, disposed of this issue by holding that an equivalent tax burden is imposed on domestic and foreign corporations under the Act of 1935 because, if appellant were a domestic corporation, its tax under said Act would have been greater than that imposed against it as a foreign corporation. In the discussion heretofore of the issue as to denial of equal protection of the laws, it was shown that this comparison had no application in the determination of that issue. The same reasoning applies here.

Under the circumstances, this Court has held that, as to the question of contract impairment by a state statute challenged as invalid, it must determine, as federal questions, the existence of the contract, and the extent of its obligations, and that it will not accord finality to the views of the state court.

Irving Trust Co. v. *Day*, 314 U. S. 556.

Appellee contends that this issue does not present a substantial federal question and in support hereof, advances four propositions:

1. That the provisions of section 1010 of the Act of 1933, quoted above, even though embodying a contract between the appellant and the Commonwealth, do not relate to matters of taxation but refer only to the rights conferred and the liabilities imposed by the Act of 1933 itself.

2. That said section 1010 did not create a contract between appellant and the Commonwealth because its rights and liabilities are to be tested as if it were incorporated under said Act of 1933; and, since under the provisions of Article XVI, section 10 of the Pennsylvania Constitution, the right to alter, revoke or annul any charter of incorporation of domestic corporations is reserved, the Certificate of Authority granted to appellant and other foreign corporations is revocable also.

3. That the said Act of 1935 constitutes an amendment, alteration or modification of the certificate of authority granted to appellant.

4. That, in any event, the alleged contract is not impaired because the tax liability of the appellant in the instant case is less than it would have been if it had been organized under the said Act of 1933.

The *American Smelting and Refining Company* case, *supra,* answers completely in the negative the first three propositions advanced by appellee. It held that language in the Colorado law similar to that in section 1010 of the Pennsylvania law related to matter of taxation; that the reservation of the power to alter, amend or revoke the charter of a domestic corporation is not applicable; and that the tax law involved was not an alteration or revocation of the privilege granted to a foreign corporation to do business in the taxing state. This case has not been overruled by *Hammond Packing Co.* v. *Arkansas,* 212 U. S. 322, cited by appellee, or by any other case decided by this Court.

Section 1013 of the said Business Corporation Law of 1933 sets forth the causes for which the Certificate of Authority of a foreign corporation may be revoked or cancelled. Appellant submits that neither under said section, nor under the reserved power in Article XVI, section 10, of the Pennsylvania Constitution, has there been an actual revocation or cancellation of appellant's Certificate of Authority; and that until such event occurs, the obligation of appellant's contract with the Commonwealth remains effective.

It is not asserted by appellant that the method used by Pennsylvania in taxing foreign corporations prior to 1935 cannot be changed. That can be done provided foreign corporations are not placed at a disadvantage as compared with domestic corporations; but appellant submits that the difference created in the Act of 1935 by excluding from the multiplicand in the tax base the value of certain investments in the case of the domestic corporation and not excluding the value of such investments from the multiplicand in the case of appellant, a foreign corporation, is a palpable breach of its contract with the Commonwealth.

As to appellee's fourth proposition, appellant submits that the test proposed by appellee for the determination of this issue is not applicable and is wholly without foundation in the law as has been shown heretofore in appellant's discussion of the issue as to the denial of equal protection of the laws.

(g)

Does the Act of 1935, as construed and applied in imposing tax on appellant, unduly and unlawfully burden interstate commerce?

This issue presents a substantial federal question since there is drawn in issue the validity of the statute as applied.

Memphis Gas Co. v. *Beeler*, 315 U. S. 649.

The question has not been passed upon directly by this Court. However, the principles laid down by this Court in other cases are against the validity of the statute as applied in the instant case.

This Court said in *Nelson* v. *Sears, Roebuck & Co.*, 312 U. S. 359, at p. 366:

> "Particular facts of specific cases determine whether a given tax prohibitively discriminates against interstate commerce. Hence, a review of prior adjudications based on widely disparate facts, howsoever embedded in general propositions, does not facilitate an answer to the present problem."

All of appellant's manufacturing plants were located outside of Pennsylvania (R. 177a). Its commercial domicile was in Chicago, Illinois (R. 177a). It had an extensive sales organization throughout the United States. Two sales offices were located in Pennsylvania, in connection with which a small inventory of goods was kept in a public warehouse (R. 181a, 182a). Salesmen connected with these two

offices obtained orders which gave rise to sales in the amount of $7,224,347.

Except for sales of $171,773 made from Pennsylvania stocks to Pennsylvania customers, the remainder of the sales in the amount of $7,052,574 arising from orders obtained by the Pennsylvania sales offices were made in interstate commerce. This is conceded by the appellee on page 40 of its Statement Opposing Jurisdiction. They were controlled by, and approved or rejected at, appellant's home office in Chicago. There, the customers' credit was passed upon, their accounts were kept, and invoices were made out. Shipments were made from stocks or from mills outside of Pennsylvania to customers in Pennsylvania in the amount of $5,341,783 and to customers outside of Pennsylvania in the amount of $1,710,781 (R. 145a, 146a, 182a, 222a). In connection with these sales, remittances were generally made to Chicago (R. 73a, 87a) and not to the Pennsylvania sales offices, as stated by appellee on page 35 of its Statement Opposing Jurisdiction. The total value of appellant's property in Pennsylvania is $22,440 (R. 180a, 183a).

In the computation of tax against appellant, the Supreme Court of Pennsylvania and appellee interpret the Act of 1935 as requiring that the intrastate receipts of $171,773 and the *whole* of the interstate receipts of $7,052,574 be included in the numerator of the gross receipts allocation fraction.

Appellant contends that, under the facts in the instant case, the said Act of 1935 as so interpreted discriminates against and burdens interstate commerce because the interstate receipts of $7,052,574, which arose from activities and employment of capital both within and without the state, are not apportioned to the commerce carried on *within* the state. If the interstate receipts without apportionment could be made the measure of a tax laid in every state where

the commerce is carried on, the interstate commerce is subjected to multiple taxation not borne by local commerce.

Western Live Stock v. *Bureau*, 303 U. S. 250.

If the "taxable value" of appellant under the Act of 1935 represents the value of its franchise exercised *within the state*, interstate commerce is unduly and unlawfully burdened when there is included in the computation of such "taxable value" gross receipts *which arose in part from franchises exercised and commerce carried on without the state.*

The use of the *whole* of the interstate receipts in the computation of the tax has been approved only where local management and manufacturing activities in the taxing state preceded the sale and where the amount of the tax did not exceed that which could have been imposed directly on the property.

Hump Hairpin Mfg. Co. v. *Emerson*, 258 U. S. 290;
United States Glue Co. v. *Town of Oak Creek*, 247 U. S. 321;

or where the *whole* of the interstate activity is carried on in the taxing state:

Western Live Stock v. *Bureau*, 303 U. S. 250;

or where the corporation has acquired a commercial domicile in the taxing state:

Memphis Gas Co. v. *Beeler*, 315 U. S. 649.

Such are not the facts in the instant case.

Where a franchise tax is imposed in lieu of a property tax and gross receipts are used to measure the true value of property and capital employed in the taxing state—as appears to be the theory in the instant case—this Court has approved the use of intrastate receipts and *only that*

part of the interstate receipts attributable to the taxing state:

Maine v. *Grand Trunk Rwy. Co.*, 142 U. S. 217;
Cudahy Packing Co. v. *Minnesota*, 246 U. S. 450;
Pullman Co. v. *Richardson*, 261 U. S. 330.

In *Matson Navigation Co.* v. *State Board*, 297 U. S. 441, this Court approved the use by California of only 22.2% of interstate receipts. Under the Texas statute, no interstate receipts are used. *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331, 335.

Appellee contends that the issue does not present any substantial federal question for the reason that the Pennsylvania tax is not a tax upon gross receipts which are used only as a measure in one of the three fractions, in computing the franchise tax upon the privilege of doing business in Pennsylvania, citing:

International Shoe Co. v. *Shartel*, 279 U. S. 429;
Hump Hairpin Mfg. Co. v. *Emmerson*, 258 U. S. 290;
Baltic Mining Co. v. *Massachusetts*, 231 U. S. 68;
Western Cartridge Co. v. *Emmerson*, 281 U. S. 511;
Western Live Stock v. *Bureau*, 303 U. S. 250.

In reply, appellant submits that the factual situations in these cases were wholly different from those in the instant case, or the principles laid down are not applicable.

In the *Shartel* case, the allocation ratio in the taxing state was local assets and *local* business, and this Court held that the tax was not invalid under the commerce clause because *property* used in computing the tax was used in interstate commerce.

In the *Hump Hairpin Manufacturing Co.* and *Western Cartridge Co.* cases, substantially all of the property was located, and local management and manufacturing activi-

ties preceding the sales were carried on, in the taxing state.

In the *Baltic Mining Co.* case, it does not appear what proportion of the interstate receipts were used in computing the tax.

In the *Western Live Stock* case, *all* the interstate activity was carried on in the taxing state.

Conclusion

It is respectfully submitted that the issues raised by appellant in this case present substantial federal questions; that this Court has jurisdiction for the reasons set forth herein; and that the Motion to Dismiss or Affirm should be denied.

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Service of a copy of the foregoing Brief this 1st day of February, 1945, is hereby acknowledged.

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